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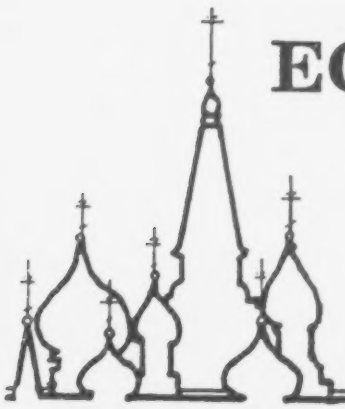


# ECONOMIC NEWSLETTER

## Russian Research Center
## Harvard University

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### Soviets Announce Convertible Currency Auction

Under the auspices of the Vneshekonombank (the Foreign Economic Bank), the Soviets plan to hold their first currency auction on November 3, 1989. Authorized under decrees announced March 12, 1988 and March 15, 1989, this currency auction will be limited to government enterprises, holding companies and organizations. There is no indication that foreign firms or joint ventures will be allowed to participate.

Under the terms of the auction, prospective buyers and sellers must submit their bids by no later than October 27. They must indicate how much they would like to buy or sell, the purpose for which the money is intended if the enterprise is buying hard currency ,and the rate that the buyer and seller are willing to pay. In case of tie bids, the bank will decide which goal has the higher priority and will award the foreign currency to that enterprise. Those interested in buying foreign currency must pay a fee of 200 rubles for participating in the auction and those offering to sell hard currency must agree to pay a fee equal to one percent of their sales but no more than 1,000 rubles.

The minimal sum that must be sold in rubles must exceed 50,000 rubles; however, the minimal sum to be purchased by those selling the hard currency must equal at least 10,000 rubles. Clearly Soviet authorities are trying to facilitate sales of hard currency because they evidently anticipate that there will be more readiness and eagerness to buy convertible currency than there will be to sell it.

However limited this initial effort is, it is nonetheless an important first step. If the auction is ultimately to be a success, it must be held with regularity and must also be open to foreign enterprises. Nonetheless it is a beginning and as the Soviets themselves acknowledge, it is an action unthinkable a few years ago.

### The Soviets Experience Problems in Oil Production

Again, because of the lack of statistics, we will have to wait until the November newsletter for a report on third quarter output. As we have mentioned in previous editions of this newsletter, glasnost' has taken a major step backwards in that data which in the past was released monthly and quarterly now appears yearly and sometimes semi-annually.

In any case, the Soviets have announced at a Supreme Soviet meeting that oil production for the first eight months of 1989 is more than 10 millions tons below the comparable figure for 1988. This is a drop of over 3%. The acknowledgment by the First Deputy Prime Minister Lev Voronin that this has happened is accompanied by a discussion of the fact that under *perestroika*, the system seems to be breaking down. No one seems to know who is in charge and there is general disorder occurring

in the petroleum industry. As a consequence, many of the gains that were made earlier when Gorbachev made a personal visit to the Tyumen oil fields have now been lost. This is a serious setback and could have implications for Soviet purchases of goods in the hard currency world. It will also place more strain not only on the domestic energy supplies but also on their ability to continue their petroleum exports. Already there have been many complaints about the lack of fuel needed to run Soviet tractors during the harvest.

## Soviets Announce Budget for 1989 and Proposed Budget for 1990

Given a budget deficit which according to some reports is equivalent to 13% of the GNP, the Soviets have been making major efforts to slash expenditures. This is reflected in part by a comparison of the 1989 budget which was approved last year and the prospective budget just recently offered for 1990. There are several factors that are worth noting. Total budget expenditures were to fall from 495 billion rubles in 1989 to 488 billion in 1990. The contraction will be accounted for in part by a reduction in the amount invested by the budget in industrial production. That will fall from 199 billion rubles to 187 billion. A major share of that drop will be attributable to the fact that the Soviets plan to reduce capital investment from 70 billion rubles in 1989 to 40 billion in 1990. The reduction will be offset, however, by a need to increase subsidies in food production. Thus subsidies will rise from 88 billion in 1989 to 96 billion in 1990.

There will also be an effort to increase what the Soviets call the non-production sphere of social and cultural financing. That will rise, as the accompanying table shows, from 144 billion rubles to 159. The major reason for the growth is an increase in pensions and social security expenditures.

The Soviets also hope to reduce their financing of foreign trade. However they acknowledge that there will be an increase in servicing costs for their past debts. The Soviets also assert that the military budget will be reduced from 77 billion rubles to 71. This figure remains questionable because they have only recently acknowledged that the budget figure was 77 billion in 1989. They were reluctant to do that and indeed were using old and now disavowed figures for some time.

Looking at the budget as a whole, what stands out is that the Soviets are trying to cut back on expenditures, particularly investment in industry and the military budget. However while they do that, they also recognize that they have to do something about their dismally low pensions and the need to continue subsidizing consumer goods. In a sense it is a race to see whether they can reduce the budget enough to stop the inflation in order to obviate the need for even larger subsidies.

**FOREIGN EXCHANGE RATES**
August 30, 1989 to September 13, 1989
Quoted in rubles

| | Aug 30 | Sept 13 |
|---|---|---|
| £100 Sterling | 100.82 | 100.10 |
| 100 Aust. Sch. | 4.66 | 4.64 |
| 100 D. Marks | 32.81 | 32.60 |
| 100 D. Guilders | 29.10 | 28.95 |
| 100 U.S. Dollars | 64.44 | 65.13 |
| 100 Fr. Francs | 9.74 | 9.67 |
| 1,000 Jap. ¥ | 4.47 | 4.40 |
| 10,000 It. Lire | 4.58 | 4.55 |
| 100 Swiss Frs. | 38.06 | 37.75 |
| 100 Nor. Kroner | 9.01 | 8.98 |
| 1,000 Bel. Frs. | 15.70 | 15.61 |
| 100 Sw. Kronor | 9.72 | 9.70 |

*Opinions and ideas expressed in this newsletter are those of the author and not the RRC or Harvard University unless otherwise indicated*
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## STATE BUDGET EXPENDITURES FOR 1989 AND 1990

| | 1989 Confirmed | | 1990 Projected | |
|---|---|---|---|---|
| | Sum | % of Total | Sum | % of Total |
| Budget Expenditures | 494,8 | 100,0 | 488,2 | 100,0 |
| I. Material production and science sphere | | | | |
| Financing of the national economy | 199,4 | 40,3 | 187,4 | 38,4 |
| of which: | | | | |
| -financing centralized capital investment | 70,3 | 14,2 | 40,5 | 8,3 |
| -subsidies for food production | 87,8 | 17,7 | 95,7 | 19,6 |
| -financing science | 7,5 | 1,5 | 11,0 | 2,3 |
| II. Nonproductive sphere | | | | |
| Financing sociocultural measures | 143,4 | 29,0 | 158,8 | 32,5 |
| of which: | | | | |
| -education, culture, and art | 46,9 | 9,5 | 48,9 | 10,0 |
| -health and physical culture | 24,9 | 5,0 | 26,7 | 5,5 |
| -social insurance and social security | 71,6 | 14,5 | 83,2 | 17,0 |
| Financing central measures for increasing living standards | 4,2 | 0,8 | 9,8 | 2,0 |
| III. Foreign economic expenditures, total | | | | |
| of which: | 31,4 | 6,3 | 26,0 | 5,3 |
| -financing foreign trade | 10,8 | 2,2 | 7,4 | 1,5 |
| -government credits and the rendering of foreign aid | 12,5 | 2,5 | 9,7 | 2,0 |
| -service of the foreign debt | 5,3 | 1,1 | 6,2 | 1,3 |
| IV. Centralized social needs | | | | |
| of which: | | | | |
| -financing defense | 77,3 | 15,6 | 70,9 | 14,5 |
| -financing government operations | 2,8 | 0,6 | 2,9 | 0,6 |
| -financing law and order of organizations | 8,6 | 1,7 | 8,8 | 1,8 |
| V. Servicing the government internal debt | 7,2 | 1,5 | 8,8 | 1,8 |
| VI. Reserve of money funds | 3,7 | 0,7 | 4,1 | 0,8 |

## Corporate Sponsor Seminars

Enclosed are the programs for the next two Corporate Sponsor Seminars: our journalist orientation on November 6 and a joint venture conference, organized with the law firm Heron, Burchette, Ruckert & Rothwell, on November 13th. Please note that we have added a Soviet journalist to the list of speakers for the November 6th conference. In addition, Mr. Peter von Braun, of the Phoenix Group International, will be speaking on November 13th. The Phoenix Group is a partner in a venture to supply and produce in the Soviet Union three million personal computers by 1994.

A delegation of Soviet economists will be visiting the RRC in mid-November and we are hopeful that they will also be able to participate in our two upcoming conferences.

# Stay Tuned For The Next Episode Of 'The Perils of Gorby'

*Despite everything, he emerges stronger politically from each crisis.*

By Marshall I. Goldman

WHAT IS happening in the Soviet Union?

On the one hand, Mikhail Gorbachev purges three of his major critics from the Politburo. On the other hand, he is not able to remove his most important rival, Yegor Ligachev, and Gorbachev's stewardship as the country's chief administrator has produced serious failures. The country seems to be in continual crisis. If it is not fighting between the Armenians and Azeris, it is a call for secession from the Soviet Union by nationalists in the Baltic states and Moldavia. And if it is not a nationwide strike by Siberian and Ukrainian coal miners, it is the imposition of sugar, sausage and even soap rationing throughout large parts of the Soviet Union.

Yet, as his most recent purge of the Politburo shows, somehow Mikhail Gorbachev seems to emerge from each crisis still in charge. It brings back memories of the "perils of Pauline." Each time our hero finds himself in an inescapable trap, and each time he somehow manages to escape, only to confront what seems to be yet another unsurmountable challenge. How long can he continue this way?

Were an opinion poll to be taken in the non-Communist world, there is little doubt that Mikhail Gorbachev would be voted the most-admired politician in the world. Ironically, were the same poll to be taken in the Soviet Union, the likelihood is that he would not do so well. It took someone like Boris Yeltsin, one of Gorbachev's critics from the Left, to impress on the American public during his recent visit that we are two years behind the times. Gorbachev's perestroika and glasnost were big hits in the Soviet Union during the first two or so years of Gorbachev's leadership, but they are not nearly as popular now. In fact, as Yeltsin repented over and over, because of Gorbachev's policies, the Soviet Union today "stands on the edge of an abyss."

Danby, Bangor Daily News

Despite the richness of its raw materials, the Soviet Union was never a country of abundance, but under Gorbachev there are now more shortages. This is a direct consequence of Gorbachev's early decision to cut back on consumer goods imports and stress machine tool production instead. Wages were being paid, but there were fewer goods to spend the money on. The result was rising prices, which in turn ignited the shortages.

Since there were no stocks or high-interest savings available, Soviet consumers quickly realized that hoarding was the only way to protect whatever money they had. In the view of many Soviet economists, the shortages that ensued were the worst since World War II.

A visitor to Moscow went into a meat store: "Do you have any sausage?" "No," came the reply. So the visitor wrote on a pad he carried: "No sausage." After visits to neighboring shops, his list continued: "no fish," "no milk," "no sugar," "no tea," "no matches," "no laundry detergent" and even "no salt." Finally a man in a leather coat accosted the visitor and demanded to know what he was doing. "Well, I haven't been to Moscow for forty years and my wife asked me to make notes on what the city is like today." Retorted the man in the leather coat, "Forty years ago, you would have been shot for this." Once more, the visitor took out his pad; this time, he wrote "no bullets."

This Moscow story reflects Gorbachev's dilemma. The economic reforms are not working, but many of the political reforms are, and thus people feel freer to express their frustrations. When the miners went out on strike, it was with the knowledge that they would not be shot or sent to prison or psychiatric hospitals as they would have been under Joseph Stalin and even Leonid Brezhnev.

And why did they strike? It was not so much an issue of more money — what the miners wanted was a ration of more than one bar of soap every three months.

The decline in the real standard of living that has taken place in the last two years has also exacerbated the nationality tensions. There would be considerably less pressure to secede from the Soviet Union if the country were prosperous. With such serious shortages, no wonder the Estonians and Lithuanians have forbidden the sale of scarce goods to shoppers from the Russian republic, particularly Moscow and Leningrad.

The Baltic peoples are also seeking to issue their own currency. If the ruble had real value, there would be no such problem. After all, while the Soviet people are demanding disintegration, the West Europeans are seeking closer integration.

So far, Gorbachev has survived each of these economic disasters. First he threatens, then he calls for reason and ultimately he promises some economic relief, even if it means larger budget deficits. And oddly enough, in the process he seems to become stronger politically. As this week's purges show, he continues to outmaneuver his party rivals. In addition to carrying out the purge, he forced them to convene the party congress four months earlier than scheduled. Moreover, in a masterful display of political adroitness, he has eviscerated the once-powerful Secretariat of the Central Committee. That as well as Gorbachev's weeding out of the Politburo was a way of reducing the power base of Yegor Ligachev, the leader of the opposition from the right. For that matter, when Gorbachev created a meaningful Supreme Soviet, most of whose members were selected in secret elections, he also reduced the power of the Politburo and the Central Committee itself.

The appearance of a robust Supreme Soviet may at least in part explain Gorbachev's continuing survival. This Supreme Soviet serves as a vent for the country's economic and political frustration and bitterness. This was an outlet unavailable to the students in China.

*'As Yeltsin repeated over and over, the Soviet Union today "stands on the edge of an abyss." '*

Undoubtedly, the switch in political power from the Party to the Supreme Soviet has helped Gorbachev in some of his latest confrontations. Yet what worked so well recently may indeed have set the stage for Gorbachev's newest crisis. What does Gorbachev do when he finds himself with anarchy in the Caucasus and calls for secession in the Baltic? Just as in the past, he has issued orders to local party leaders. He has told them to fall in line with Moscow's policy. But now the local party leaders complain to Gorbachev that in the aftermath of the creation of the Supreme Soviet, they and the local parties have lost power and cannot do as he orders, particularly as the economic situation continues to deteriorate.

Admittedly, Gorbachev has escaped from similar "impossible" straits before. And the new Politburo lineup shows he still has political muscle. But unless he can improve day-to-day economic life and do it soon, it is hard to see how he will manage to survive his continuing adventures, particularly if in the process he destroys the very institutions that have been the source of his past power.

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# Gorbachev Shows Off, but Soviets Wonder 'Where's the Beer?'

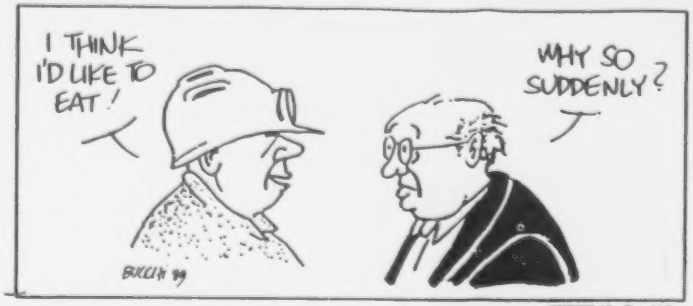
By MARSHALL I. GOLDMAN

The timing is perfect. Rumors have been circulating in Washington and other capitals that Soviet President Mikhail S. Gorbachev is in trouble, that there will be a coup and that George Bush should not negotiate with Gorbachev because he may not be there next year.

What better way to impress on the world that Gorbachev is still very much in command than to conduct an old-fashioned purge of the Politburo, timed for the day before Foreign Minister Eduard Shevardnadze arrived to start negotiations with Bush and Secretary of State James A. Baker III.

Without doubt, this latest purge shows just how strong Gorbachev is. It is amazing how easily he can reshape the Politburo, the party's main governing body. A comparison of the Politburo roster in March, 1986, a year after Gorbachev's takeover, with the roster today shows that six, or one-half, of the members have been purged. A few months ago, Gorbachev single-handedly emasculated the Communist Party secretariat, which was also the power base of Gorbachev's conservative opponent, Yegor Ligachev. To undercut Ligachev, Gorbachev simply abolished the secretariat.

Equally important, Gorbachev has weakened the party itself. He correctly came to see that senior party bureaucrats were the most determined opponents of his *perestroika* and *glasnost* efforts. The easiest way to eliminate such resistance was to create some other source of power. That was a major consideration for his decision to create a Congress of Peoples' Deputies and a Supreme Soviet whose members in large part would be elected in secret, and in contested elections. The Supreme Soviet today more closely resembles a Western parliament than anything else that has ever existed in the Soviet Union. Just as Gorbachev intended, it has begun to assume powers formerly exercised by the Politburo.




BUCCHI / La Repubblica
Rome

But there is more involved in this most recent purge than just the flaunting of Gorbachev's political power. What remains to be seen is if this political muscle can be translated into more effective social and economic policies. Indeed, this change of leadership reflects not only Gorbachev's strengths but the troubles he is having in trying to reshape the Soviet economy.

Most Soviet economists agree that *perestroika* is not working, and that under Gorbachev, the real standard of living has actually deteriorated. For example, rationing for such basic products as meat, milk and even salt and soap has been introduced in most of the Soviet Union. For the first time since 1947, Moscow has sugar rationing. No wonder workers are striking and some ethnic groups are calling for secession. As an astute political observer, Gorbachev knows the public is eager for some sign of change.

He also knows that change in the composition of the Politburo is not the same as the revitalization of the Soviet Union. There is a fairy tale Russians like to tell. A group of monkeys decided to organize an orchestra. The leader passed out instruments, but all they heard was noise. "I know what's wrong," said the leader. "We are sitting in the wrong chairs!"

There are new members in new chairs, but *perestroika* seems much as it was before. Gorbachev has appointed some officials from regions where there has been an improvement in agriculture, and where the goods shortages are not as serious as elsewhere in the country. But without some underlying change, it is hard to see how personnel changes alone will revive Soviet society.

Undoubtedly, Gorbachev is in a better position to promote his program now that he has rid himself and the Politburo of conservatives like Vladimir V. Shcherbitsky, a long-time opponent of change from the Ukraine and Viktor M. Chebrikov, the former head of the KGB and a staunch defender of law and order and recently an open critic of the disorder associated with the nationality and labor union protests.

But the third purged member of the Politburo, Viktor P. Nikonov, was appointed by Gorbachev himself and has been in the Politburo only since June, 1987. From all the evidence, he has been a supporter of *perestroika*. However, it was his misfortune to be the secretary for agriculture, one of the major failures of Gorbachev's program. But his departure will not be enough to revitalize Soviet agriculture, especially since Ligachev, Gorbachev's most serious opponent, remains in the Politburo as head of the agriculture policy commission. Indeed, it is Ligachev who has been the most outspoken against private and family farms, and for retaining the state and collective farms. As long as he remains in the Politburo, Soviet peasants are unlikely to set off in large numbers to work on their own farms.

It is also significant that Gorbachev found it necessary to leapfrog Vladimir Kryuchkov, the head of the KGB, into position as a full member of the Politburo. Evidently Gorbachev realized that if he purged Chebrikov, who spoke for the KGB, he had to have some continuing voice from the KGB. However, such a promotion has probably caused resentment among the military, because Dmitri Yazov, the minister of defense, remains only a candidate member.

There is no doubt that Gorbachev is very much in charge. But while the faces have changed, the policies remain much as they did before. And after 4½ years as general secretary, Gorbachev himself has acknowledged that these reforms have not produced the economic improvements he promised.

As a recent story in Moscow has it, a man went into a bar and asked for a pitcher of beer. "That will be one ruble," said the bartender. "But it was only 50 kopecks a few months ago," replied the customer. "Ah, but that was before *glasnost*—now there is a 50-kopeck charge for *glasnost*." So the customer gave the bartender one ruble, but the bartender returned 50 kopecks' change. "What is this?" the customer asks. "You said I had to pay 50 kopecks for *glasnost*." "Yes," answered the bartender, "but we don't have any beer!"

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